

Office of the State Auditor
Division of State Audit

Comprehensive Annual
Financial Report
State of North Dakota

Governance Communication
Including the Report on Internal Control,
Compliance and Other Matters

For the year ended June 30, 2008
Client Code 100

Robert R. Peterson
State Auditor



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Transmittal Letter

December 18, 2008

Legislative Audit and Fiscal Review Committee

Honorable John Hoeven, Governor

Members of the North Dakota Legislative Assembly

Pam Sharp, CPA, Director
Office of Management and Budget

I am pleased to submit our report on internal control, compliance, and other matters for the state of North Dakota. This report relates to the audit of the state's basic financial statements for the year ended June 30, 2008. This report on internal control, compliance, and other matters has been completed in accordance with *Government Auditing Standards*, as issued by the Comptroller General of the United States.

Also enclosed you will find our audit findings, governance communication, passed audit adjustments and management letter. These communications are required by auditing standards.

The audit manager for this audit was Ron Tolstad Jr., M. Acc., CPA. Inquiries or comments relating to this audit may be directed to Mr. Tolstad by calling him at (701) 328-2243. I would like to express my appreciation to Ms. Sharp and her staff for the courtesy, cooperation, and assistance they provided to this office during the audit.

Respectfully submitted,

Robert R. Peterson
State Auditor

*State of North Dakota
Governance Communication
For the year ended June 30, 2008*

Executive Summary

Responses to LAFRC Audit Questions

1. What type of opinion was issued on the financial statements?

An unqualified (clean) opinion was given on the state of North Dakota's financial statements.

2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?

Yes.

3. Was internal control adequate and functioning effectively?

No. See the significant deficiencies included in this report under "Findings, Recommendations, and Management Response." Findings 08-1 through 08-2 are considered to be material weaknesses.

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

No.

5. Has action been taken on findings and recommendations included in prior audit reports?

Yes, except Findings 08-3 and 08-5 are prior recommendations that have not been completely implemented. Finding 08-5 was partially implemented.

6. Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.

Yes. The Management letter is included on page 21 of this report.

LAFRC Audit Communications

- 1. Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

There were no significant changes in accounting policies, and no management conflicts of interest or significant unusual transactions noted. The state's commitments and contingencies are reported on pages 113-116 of the Comprehensive Annual Financial Report.

- 2. Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

Management's estimates of claim losses relating to insurance activities include Workforce Safety and Insurance, Risk Management Fund, and the Fire and Tornado Fund. For Workforce Safety and Insurance, actuaries are employed to assist in calculating the liability. Other auditors evaluated the key factors and assumptions used to develop the liability and the actuary's qualifications in determining that it is reasonable in relation to the financial statements taken as a whole. Estimated claim losses for the other insurance activities are made by professional insurance adjusters on a case by case basis. We evaluated the key factors and assumptions used to develop the liability in determining that it is reasonable in relation to the financial statements taken as a whole.

Management's estimates of pension liabilities are based on valuation of actuarial amounts, provided by reputable actuaries. Other auditors evaluated the key factors and assumptions used to develop the liability and the actuaries' qualifications in determining that pension liabilities are reasonable in relation to the financial statements taken as a whole.

Management's estimate of the Medicaid liability is based on historical trends and analysis of individual components. We evaluated the key factors and assumptions used to develop the liability in determining that it is reasonable in relation to the financial statements taken as a whole.

Allowance for loan losses and receivables are based on management's periodic review of their collectability in the light of historical experience, the nature of the receivable, adverse situations that may affect the borrower's ability to repay, and where applicable the value of any collateral and loan guarantees. Other auditors and we evaluated the key factors and assumptions used to develop the allowance in determining the allowances were reasonable in relation to the financial statements taken as a whole.

Tax refunds payable are based on historical trends and analysis of individual components. We evaluated the key factors and assumptions used to develop

the liability in determining it is reasonable in relation to the financial statements taken as a whole.

3. Identify any significant audit adjustments.

Material audit adjustments are discussed in Findings 08-1, 08-2, 08-6, and 08-7.

4. Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.

We did not have any disagreements with management that were significant to the financial statements.

5. Identify any serious difficulties encountered in performing the audit.

We did not experience any serious difficulties in performing the audit.

6. Identify any major issues discussed with management prior to retention.

This is not applicable for audits conducted by the Office of the State Auditor.

7. Identify any management consultations with other accountants about auditing and accounting matters.

While OMB does employ consultants to assist in the preparation of the CAFR, we are not aware of any applicable management consultations with other accountants.

8. Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.

ConnectND Finance and Human Resource Management System (HRMS) are the most high-risk information technology systems critical to the operations of the state. There are numerous other high-risk systems which are identified in the agency audit reports. The significant deficiency identified as Finding 08-5 directly relate to these systems.

Report on Internal Control, Compliance, and Other Matters

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Honorable John Hoeven, Governor
of the State of North Dakota

Members of the Legislative Assembly
of the State of North Dakota

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the state of North Dakota as of and for the year ended June 30, 2008, which collectively comprise the state's basic financial statements and have issued our report thereon dated December 18, 2008. Our report was modified to include a reference to other auditors, for the emphasis of a matter (the actuaries for the ND Teachers' Fund for Retirement and the ND Public Employee Retirement System found the statutory contribution rates are insufficient) and as described in Note 18 to the basic financial statements, the Bank of North Dakota elected to present an unclassified balance sheet because the presentation of a classified balance sheet would be misleading to the extent that the financial statements may be materially misstated. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. As described in our report on the state of North Dakota's financial statements, other auditors audited the financial statements of the following entities:

Bank of North Dakota
Beginning Farmer Revolving Loan Fund
Board of University and School Lands
Building Authority
College SAVE Plan
Community Water Facility Loan Fund
Developmentally Disabled Facility
Loan Program
Guaranteed Student Loan Program
Housing Finance Agency

Job Service North Dakota
Mandan Remediation Trust
PACE and Ag PACE Funds
Public Employees Retirement System
Retirement and Investment Office
State Fair Association
Student Loan Trust
Workforce Safety and Insurance
All Discretely Presented Component
Units

This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of the North Dakota University System's component units, which were audited by other auditors, were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the state of North Dakota's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the state of North Dakota's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the state of North Dakota's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying schedule of findings, recommendations, and management responses (Findings 08-1 through 08-7) to be significant deficiencies in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider Findings 08-1 and 08-2 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the state of North Dakota's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to the Office of Management and Budget in a separate letter dated December 18, 2008, included in this report under "Management Letter."

The state of North Dakota's responses to the findings identified in our audit are included in the accompanying schedule of findings, recommendations, and management responses. We did not audit the state of North Dakota's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Office of Management and Budget and others within the state, Legislative Audit and Fiscal Review Committee, members of the North Dakota Legislative Assembly, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Robert R. Peterson
State Auditor

Edwin J. Nagel, Jr., CPA
Director

December 18, 2008

Findings, Recommendations, and Management Responses

Finding 08-1

Lack of Adequate Resources Devoted to Financial Reporting

Due to turnover and other factors, including other work duties of the CAFR staff and the late receipt of the University System audit report, the Office of Management and Budget (OMB) did not have a sufficient number of trained staff for financial statement preparation. While additional contractor resources may be necessary, that alone may not be enough if additional staff resources are not available. These problems resulted in delays in financial statement preparation and several material audit adjustments, many of which would have been found by OMB's professional staff, if they had adequate time. Errors included:

- We noted 64 errors in the 673 CAFR adjustments tested for an error rate of 9.5%. State agencies made 37 of the errors, while 27 were made by OMB. Corrected errors exceeded \$14.3 million and projected uncorrected errors were estimated to be \$5.4 million.
- Government wide adjustments included errors to internal receivables of \$58 million and four net asset errors of \$3.2, \$4.1, \$8.6 and \$16 million.
- Several errors were noted relating to incorporating University System financial statements into the state's financial statements. Errors were in excess of \$26 million.

Internal Control—Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission indicates an adequate control environment includes assignment of authority and responsibility such that appropriate numbers of people are available for accounting functions.

Recommendation:

The Office of Management and Budget should dedicate adequate resources to financial statement preparation to ensure professional staff have the time to prepare the financial statements timely with fewer errors.

Views of Responsible Officials / Planned Corrective Actions:

OMB agrees with the recommendation. The turnover of experienced staff did create problems, but as our new staff gain experience, delays and errors will diminish. We intend to maximize the use of consultants and other OMB staff for CAFR preparation, however, we also need to receive the University System audit report timely to allow adequate time to prepare and review the adjustments needed to incorporate their statements into the CAFR.

Finding 08-2

Improper Financial Reporting by the Department of Transportation

A spreadsheet error by the Department of Transportation resulted in an audit adjustment of over \$61 million. The incorrect amount was reported to the Office of Management and Budget on their GASB 34 Closing Package. This error double counted construction in progress and would have overstated the amount reported as capital grants on the Statement of Activities.

Internal Control—Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission indicates there should be adequate controls surrounding the development of spreadsheets. Further, supervisory reviews should ensure significant amounts are being calculated and reported correctly.

Recommendation:

We recommend the Department of Transportation implement controls to ensure spreadsheets are constructed properly and strengthen its ongoing monitoring activities to ensure that when supervisors approve closing packages the amounts are properly reported.

Views of Responsible Officials / Planned Corrective Actions:

NDDOT concurs with the finding and recommendation. NDDOT staff will provide closer scrutiny of spreadsheet development and modifications to help insure that financial data is properly reported.

Finding 08-3

Establishing Adequate Fraud Programs and Controls **(Prior Recommendation not Implemented)**

The state of North Dakota does not have adequate fraud programs and controls. This includes not having: 1) policies or procedures relating to a formal systematic risk assessment process which should include a thorough fraud risk assessment; 2) policies requiring agencies to have a comprehensive code of conduct; and 3) adequate policies relating to background investigations.

The most important guidance relating to internal control is contained in *Internal Control – Integrated Framework* published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This framework includes discussions about the importance of adequate risk assessment, code of conduct, and background investigations.

We are not aware of any state agency that has an adequate risk assessment process. Some state agencies have adequate codes of conduct, but many do not. OMB policy 112 “Employee Criminal History Background Checks” requires background checks for certain people who have access to personal information stored on the state’s PeopleSoft system. However, the policy does not include all individuals with access to personal information, positions of accounting and financial oversight, and positions of trust.

Without adequate fraud risk programs and controls the state exposes itself to risk of loss of assets, potential liabilities, and damage to the state’s reputation.

Recommendation:

We recommend the Office of Management and Budget ensure state agencies have adequate policies and procedures relating to: 1) formal systematic risk assessment process which includes a thorough fraud risk assessment; 2) comprehensive code of conduct; and 3) adequate background investigations.

Views of Responsible Officials / Planned Corrective Actions:

OMB agrees with the recommendation. We are currently in the process of developing policies and procedures to address the risk assessment process, code of conduct and background investigations.

Finding 08-4

Lack of State Agency General Ledger Transaction Approval

No documentation exists to verify that some general ledger transactions processed by the Game and Fish Department and the Department of Transportation were properly approved.

Prior to the implementation of the PeopleSoft general ledger workflow approval process these agencies did not maintain a manual general ledger transaction approval process with an audit trail. The Department of Transportation did have an internal policy that someone other than the preparer had to release the transaction into the accounting system (this would be the approval), but there is no record of who actually released the transaction and the accounting system had no controls to ensure the segregation of these duties.

Internal Control—Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission indicates independent approval of transactions is a critical part of adequate segregation of duties and internal control.

Recommendation:

We recommend the Game and Fish Department and the Department of Transportation take steps to ensure all general ledger transactions are approved by an individual independent of initiation and preparation.

Views of Responsible Officials / Planned Corrective Actions:

Game and Fish Department

The department was signing the worksheet that goes to OMB, but not the processed PeopleSoft transaction sheet. We will comply with the recommendation and begin signing both sheets effective March 1, 2009.

Department of Transportation

NDDOT concurs with the finding and recommendation. The Department of Transportation implemented PeopleSoft workflow to approve general ledger transactions in June of 2008. In the event that NDDOT staff becomes aware that an approval function within PeopleSoft financials is not functional, we will implement a manual approval process until the issue is resolved.

Finding 08-5

Limiting Access to Information Technology Applications (Prior Recommendation Partially Implemented)

Individuals have access to information technology applications beyond what is necessary to perform their job duties. We noted this security weakness at the following agencies with the applications shown in parenthesis:

- Department of Human Services - (Child Care Assistance, Vocational Rehabilitation Information System, and Comprehensive Child Welfare Information and Payment System).
- Department of Public Instruction - (Food and Nutrition).

Policies and procedures should be in place to ensure: individuals only have access necessary to perform their job duties; an individual is assigned the responsibility of controlling access to all applications; and ongoing reviews are performed to ensure access rights are properly maintained. Without these controls, there is an increased likelihood of unauthorized access to confidential or sensitive information and fraud.

Recommendation:

We recommend the Department of Human Services and the Department of Public Instruction:

1. Establish policies and procedures to restrict access privileges to only necessary individuals.
2. Assign ongoing responsibility for security for each information technology application.
3. Perform continuing reviews of access privileges.

Views of Responsible Officials / Planned Corrective Actions:

Department of Human Services

The Department of Human Services will continue to enhance procedures surrounding access to technology applications.

Department of Public Instruction

The Department of Public Instruction concurs with this finding and has implemented procedures to comply with the recommendations.

Finding 08-6

Inaccurate Estimates by the Judicial Branch

The allowance for uncollectible receivables for the Judicial Branch was not properly estimated. Further analysis resulted in the Judicial Branch increasing the allowance for various funds by \$5.8 million. The incorrect amount was reported to the Office of Management and Budget on their Miscellaneous Receivables Closing Package.

Internal Control—Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission indicates there should be adequate controls surrounding the development of estimates. Further, supervisory reviews should ensure significant estimates are being properly calculated and reported.

Recommendation:

We recommend the Judicial Branch properly estimate the allowance for uncollectible receivables and strengthen the supervisory review of closing packages to ensure amounts are properly calculated and reported.

Views of Responsible Officials / Planned Corrective Actions:

The Judicial Branch began reporting Accounts Receivable and estimating an allowance for uncollectible receivables after the state assumption of eleven clerk of court offices in April 2001. Information on court accounts receivable are generated from the court's case management system (UCIS). Because the intent of UCIS is to primarily manage caseflow, much of the financial component was added in 2001 or thereafter. The financial component has constantly been evolving to provide more accurate information. Because of this, the court's accounts receivable and allowance for uncollectibles were based on some estimates and assumptions. The judiciary has taken steps to insure the accuracy of the accounts receivable and allowance for uncollectible accounts. Therefore, the judiciary agrees with the above recommendation and will take steps to further insure the accuracy of the allowance for uncollectibles and strengthen the supervisory review of our closing packages.

Finding 08-7

Financial Reporting Error by the State Treasurer

The Office of the State Treasurer reported an incorrect amount to the Office of Management and Budget on an interest payable closing package. This \$3.8 million error was the result of taking the wrong number off of a report.

Internal Control—Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission indicates there should be adequate controls to ensure all required financial information is properly reported. Further, supervisory reviews should ensure significant amounts are being properly reported

Recommendation:

We recommend the State Treasurer take more care completing closing packages and strengthen the supervisory review of closing packages to ensure amounts are properly reported.

Views of Responsible Officials / Planned Corrective Actions:

The Treasurer's Office agrees with the recommendation and will dedicate more time to the review process of closing package preparation.

Governance Communication

Legislative Audit and Fiscal Review Committee
North Dakota Legislative Assembly

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the state of North Dakota for the year ended June 30, 2008, and have issued our report thereon dated December 18, 2008. Professional standards require that we provide you with the following information related to our audit.

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by state of North Dakota are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2008. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- Management's estimates of claim losses relating to insurance activities include Workforce Safety and Insurance, Risk Management Fund, and the Fire and Tornado Fund. For Workforce Safety and Insurance, actuaries are employed to assist in calculating the liability. Other auditors evaluated the key factors and assumptions used to develop the liability and the actuaries' qualifications in determining that it is reasonable in relation to the financial statements taken as a whole. Estimated claim losses for the other insurance activities are made by professional insurance adjusters on a case by case basis. We evaluated the key factors and assumptions used to develop the

liability in determining that it is reasonable in relation to the financial statements taken as a whole.

- Management's estimates of pension liabilities are based on valuation of actuarial amounts, provided by reputable actuaries. Other auditors evaluated the key factors and assumptions used to develop the liability and the actuaries' qualifications in determining that pension liabilities are reasonable in relation to the financial statements taken as a whole.
- Management's estimate of the Medicaid liability is based on historical trends and analysis of individual components. We evaluated the key factors and assumptions used to develop the liability in determining that it is reasonable in relation to the financial statements taken as a whole.
- Allowance for loan losses and receivables are based on management's periodic review of their collectability in the light of historical experience, the nature of the receivable, adverse situations that may affect the borrower's ability to repay, and where applicable the value of any collateral and loan guarantees. Other auditors and we evaluated the key factors and assumptions used to develop the allowance in determining the allowances were reasonable in relation to the financial statements taken as a whole.
- Tax refunds payable are based on historical trends and analysis of individual components. We evaluated the key factors and assumptions used to develop the liability in determining that it is reasonable in relation to the financial statements taken as a whole.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. The schedule titled "Passed (Uncorrected) Audit Adjustments" summarizes uncorrected misstatements of the financial statements and is included on page 20 of this report. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. Findings 08-1, 08-2, 08-6 and 08-7 discuss material misstatements detected as a result of audit procedures that were corrected by management.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated June 30, 2008.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention. It should be noted that the retention of the State Auditor is a matter of state law and is not under the control of the Office of Management and Budget.

Our opinion on the June 30, 2008 financial statements included the following paragraphs that emphasize significant problems with the funding of two of the state of North Dakota's pension plans:

The actuary for the North Dakota Teachers' Fund for Retirement has determined the Fund's unfunded actuarial accrued liability is approximately \$421 million at June 30, 2008. The funding for the actuarial accrued liabilities is predicated on employer and employee funding rates mandated by North Dakota statutes. The actuary has determined that the current statutory contribution rates will amortize the unfunded actuarial accrued liability over 57 years, based on the current actuarial assumptions, unless there are sufficient actuarial gains in the future to offset the recent investment losses.

The actuary for the North Dakota Public Employees Retirement System has determined that the Fund's unfunded actuarial accrued liability is approximately \$128 million at June 30, 2008. The funding for the actuarial accrued liabilities is predicated on employer and employee funding rates mandated by North Dakota statutes. The actuary has determined that the current statutory contribution rates are insufficient to meet the actuarially determined requirement, based upon the current assumptions, unless there are sufficient actuarial gains in the future to offset the recent investment losses.

These problems go back several years, they were first emphasized in the Teachers' Fund for Retirement's 2005 auditor's report and the Public Employees Retirement System's 2006 auditor's report. With the severe market downturn referenced in note 20 to the state's financial statements this problem has become significantly worse.

This information is intended solely for the use of Legislative Audit and Fiscal Review Committee, the Legislative Assembly and management of state of North Dakota and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully yours,

Ron Tolstad Jr., M. Acc., CPA

Passed (Uncorrected) Audit Adjustments

Note: Errors below the Auditor's trivial misstatement amounts are not included below.

1. Passed Audit Adjustment

Department of Human Services overstated receivables on their refund receivables summary form for federal funds.

	Debit	Credit
Fund Statement Effect		
Federal Fund		
Intergovernmental Receivable	\$504,225	
Intergovernmental Revenue		\$504,225

2. Passed Audit Adjustment

Department of Human Services overstated receivables on their refund receivables summary form for federal funds.

	Debit	Credit
Fund Statement Effect		
Federal Fund		
Grants to Individuals	\$324,727	
Intergovernmental Receivable	324,727	
Accounts Receivable		\$324,727
Intergovernmental Revenue		324,727

3. Passed Audit Adjustment

Department of Corrections and Rehabilitation overstated the allowance for uncollectible receivables on their miscellaneous receivable summary form.

	Debit	Credit
Fund Statement Effect		
Federal Fund		
Allowance for Uncollectible Receivables	\$350,200	
Deferred Revenue		\$350,200

Management Letter

December 18, 2008

Ms. Pam Sharp, CPA
Director
Office of Management and Budget
State Capitol
600 E. Boulevard Avenue
Bismarck, North Dakota 58505

Dear Ms. Sharp:

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the state of North Dakota as of and for the year ended June 30, 2008, which collectively comprise the state's basic financial statements and have issued our report thereon dated December 18, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, by the Comptroller General of the United States. We have issued our report on internal control over financial reporting and on compliance based on an audit of financial statements performed in accordance with *Government Auditing Standards*. That report should be considered in conjunction with this management letter.

In connection with the audit, gaining an understanding of internal control, and tests of compliance with laws and regulations we noted certain conditions that we did not consider reportable as defined by *Government Auditing Standards*. We want to present these findings and recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will then reconsider their status. These control deficiencies were considered in preparing the report referenced above and in no way alter that report.

Informal findings and Recommendations:

Informal Finding 08-1

ConnectND HRMS Access

OMB does not adequately monitor users with superuser and security administrator access to ConnectND HRMS. Upon our review, OMB locked several user IDs for employees at OMB. In addition, one employee was identified that was no longer employed at OMB but still had security administrator access.

Recommendation

We recommend the OMB:

1. Establish policies and procedures to restrict access privileges to only necessary individuals.
2. Assign ongoing responsibility for security for each information technology application.
3. Perform continuing reviews of access privileges.

Informal Finding 08-2

Inadequate CAFR and Entity-wide Adjustment Support

Certain adjustments made by the Office of Management and Budget (OMB) were not adequately supported. This not only makes auditing more difficult, but it also makes supervisor review more difficult. It also introduces inefficiencies as subsequent years the entry is harder to recreate.

Recommendation

We recommend the Office of Management and Budget develop procedures to ensure that all adjustments used in the preparation of the CAFR are properly supported.

Informal Finding 08-3

Closing Package Improvements

Certain closing packages do not gather the needed information or should have better instructions (specifically the Prepaid Asset Closing Package, Interest Receivable Summary Form and Special Governmental Unit Closing Package).

Recommendation

OMB should take a critical look at closing packages to ensure all required information is being obtained and the instructions are as clear as possible.

Informal Finding 08-4

Grants to Colleges Reclassification to Transfers

Several errors were noted during our testing of the account "Grants to State Colleges" transactions processed by the colleges and universities to reclassify them to transfers by OMB.

Recommendation

We recommend the Office of Management and Budget properly prepare the grants to transfers reclassification adjustment for colleges and universities.

Management of the Office of Management and Budget agreed with these recommendations.

I would like to take this time to thank you and your staff, especially Eileen Holwegner, for the cooperation we received during our audit. Please don't hesitate to contact me if you have any questions.

Sincerely,

Ron Tolstad Jr., M. Acc., CPA
Audit Manager